

Internal Audit Department

O R A N G E C O U N T Y
6th Largest County in the USA

FIRST FOLLOW-UP AUDIT

AUDIT OF COUNTYWIDE PENSION PRACTICES

ORIGINAL AUDIT No. 2913

AS OF SEPTEMBER 27, 2010

Our First Follow-Up Audit found one (1) recommendation closed and two (2) recommendations partially implemented. These recommendations were from our original audit report dated March 26, 2010. We performed the original audit of certain Human Resources records and related documents for the period from July 1, 2006 through June 30, 2009 to respond to the recommendation made to the Internal Audit Department in the Orange County Grand Jury report entitled "The Guardian of Last Resort."

AUDIT No: 1016-B
REPORT DATE: OCTOBER 18, 2010

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Deputy Director: Eli Littner, CPA, CIA
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RISK BASED AUDITING

GAO & IIA Peer Review Compliant – 2001, 2004, 2007, 2010



Member of
American Institute of Certified Public Accountants Award to Dr. Peter Hughes as 2010 Outstanding CPA of the Year for Local Government



2009 Association of Certified Fraud Examiners' Hubbard Award to Dr. Peter Hughes for the Most Outstanding Article of the Year



2008 Association of Local Government Auditors' Bronze Website Award

2005 Institute of Internal Auditors' Award to IAD for Recognition of Commitment to Professional Excellence, Quality, and Outreach



ORANGE COUNTY BOARD OF SUPERVISORS'
Internal Audit Department

GAO & IIA Peer Review Compliant - 2001, 2004, 2007, 2010

Providing Facts and Perspectives Countywide

RISK BASED AUDITING

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 OC Internal Audit Department, visit our website: www.ocgov.com/audit



OC Fraud Hotline (714) 834-3608



Transmittal Letter



Audit No. 1016-B October 18, 2010

TO: Carl H. Crown, Director
Human Resources Department

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

SUBJECT: First Follow-Up Audit of Countywide
Pension Practices, Original Audit No.
2913, Issued March 26, 2010

We have completed a First Follow-Up Audit of Countywide Pension Practices. Our audit was limited to reviewing, as of September 27, 2010, actions taken to implement the three **(3) recommendations** from our original audit. We conducted this First Follow-Up Audit in accordance with the *FY 10-11 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee and Board of Supervisors (BOS).

The results of our First Follow-Up Audit are discussed in the **OC Internal Auditor's Report** following this transmittal letter. Our First Follow-Up Audit found that **one (1) recommendation was closed and two (2) recommendations were partially implemented**. The Human Resources Department is committed to addressing the remaining recommendations by the Second Follow-Up Audit in approximately six months from this report date.

Each month I submit an **Audit Status Report** to the BOS where I detail any material and significant audit findings released in reports during the prior month and the implementation status of audit recommendations as disclosed by our Follow-Up Audits. Accordingly, the results of this audit will be included in a future status report to the BOS.

Other recipients of this report are listed on the **OC Internal Auditor's Report** on page 4.

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Countywide Pension Practices
Audit No. 1016-B*

As of September 27, 2010

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Audit No. 1016-B

October 18, 2010

TO: Carl H. Crown, Director
Human Resources Department

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

A handwritten signature in blue ink that reads "Peter Hughes".

SUBJECT: First Follow-Up Audit of Countywide Pension Practices, Original Audit No. 2913,
Issued March 26, 2010



Scope of Review

We have completed a First Follow-Up Audit of Countywide Pension Practices. Our audit was limited to reviewing, as of September 27, 2010, actions taken to implement the **three (3) recommendations** from our original audit report.

Background

We performed an audit of certain Human Resources records and related documents for the period from July 1, 2006 through June 30, 2009 in response to the recommendation made to the Internal Audit Department in the Orange County Grand Jury report entitled "The Guardian of Last Resort" on the Public Administrator/Public Guardian, dated May 9, 2009. We determined if additional instances of questionable pension practices exist in agencies other than the Public Administrator/Public Guardian's Office. In addition, we identified internal control weaknesses for which we provided recommendations for improvement.

Results

Our First Follow-Up Audit indicated that **one (1) recommendation was closed and two (2) recommendations were partially implemented**. Based on the First Follow-Up Audit we conducted, the following is the implementation status of the three (3) findings and resulting three (3) recommendations:

1. **Questionable Promotion and Salary Increases (Control Finding)**

We recommended that the Human Resources Department advise all appropriate levels of management on the impact of salary increases and future pension costs.

Current Status: Closed. During our review of a sample of employee salary increases in our original audit, we identified two instances where employees received a promotion and large "End-of-Career" salary increases at departments other than the Public Administrator/Public Guardian's Office. Based upon our review of documentation, the two promotions and salary increases did not technically violate Human Resources Department (HRD) policies and procedures, but were questionable management actions. It should be noted that the three instances of questionable promotion and salary increases identified by the Grand Jury and the Internal Audit Department represented a negligible portion of the retirees with 778 of the 781 (99.62%) not open to such apparent challenge.



HRD partially concurred with the finding and recommendation on questionable promotion and salary increases. HRD's management response indicated that although the three questionable actions were within policy, the circumstances surrounding these actions and lack of documentation allowed for the decisions to be called into question. HRD indicated that County department executives and department human resources managers are usually not aware of a person's retirement intentions since the employee is not obligated to provide advance notice of their intended retirement date. HRD further indicated that the compliance rate as stated in the findings, 99.62%, demonstrates that "end-of-career" salary increases were overwhelmingly in compliance with both the letter and intent of County Policy. HRD concluded that an educational effort was not deemed necessary due to the very high compliance rate. Because HRD accepted the risk of not taking further action, we consider the recommendation to be closed.

2. **Authorization of Salary Increases (Control Finding)**

We recommended that the Human Resources Department require pre-authorization of permanent and temporary promotions from the County Executive Officer for proposed and/or cumulative salary increases exceeding 15% prior to submission to the Board of Supervisors for their review and approval.

Current Status: Partially Implemented. We noted that HRD developed new procedures to ensure that proper salary increase documentation is recorded when a department/agency sets salary levels above the bottom of the range for individual employees in the classifications of Administrative Manager, Executive Manager, and Law Enforcement Manager. In a memorandum to all department and agency HR managers, *Salary Increase Documentation and Approval Policy*, dated July 23, 2010, the Director of Human Resources provided new procedures to strengthen HR policies and procedures within the County. The new procedures for a salary increase of 15% or greater requires pre-approval from the Human Resources Director, the Deputy County Executive Officer (for non-elected department/agency heads), and the County Executive Officer. The request for a salary increase of 15% or more must be approved prior to making a job offer.

We reviewed all six (6) of the salary increases of 15% or more effective after July 23, 2010 received by four (4) Executive Managers and two (2) Law Enforcement Managers. During our review, we found that:

- A. Approval for the salary increases of 15% or more granted to the four (4) Executive Managers complied with HRD's new policies and procedures. All four (4) salary increases received preapproval prior to the update of employment status for the Executive Managers.
- B. "Base" salary increases of 15.51%, separate from premium pay, received by two (2) Law Enforcement Managers were not approved by the Human Resources Director and County Executive Officer in accordance with new HRD policies and procedures. It was noted that HRD detected the two salary increases after they occurred and reminded the department of the new approval and documentation requirements.

Although HRD took action to address our recommendation, certain salary increases did not receive prior approval in accordance with policies and procedures; therefore, we consider this recommendation partially implemented.



Human Resources Department Planned Action:

HRD will remind agency and department HR Managers in an upcoming HR Leadership Forum of the requirements and documentation required per the new policy and procedures for salary increases of 15% or greater issued after July 23, 2010.

3. Monitoring Salary Decisions (Control Finding)

We recommended that the Human Resources Department take appropriate actions to ensure monitoring of management salary increases are documented, reviewed and maintained on file for third party confirmation.

Current Status: Partially Implemented. As noted above, HRD developed new procedures to ensure that proper salary increase documentation is recorded when a department/agency sets salary levels above the bottom of the range for individual employees in the classifications of Administrative Manager, Executive Manager, and Law Enforcement Manager. In a memorandum to all department and agency HR managers, *Salary Increase Documentation and Approval Policy*, dated July 23, 2010, the Director of Human Resources provided that certain proposed salary increases are required to be processed and submitted on a memorandum entitled *Salary Increase of 15% or Greater Request* through the department/agency's HRD service team manager. The memorandum proposing the salary increase is required to state the reason for the salary action, prior salary, salary percentage increase, new salary, effective date, and justification with internal and external salary comparisons, education, and experience. Following approval, the memorandum will be returned to the department/agency and will be scanned into the employee's personal file. For market equity adjustment granted pursuant to the memorandum of understanding for administrative management, the department/agency is required to complete a memorandum entitled *Equity Salary Increase* and scan the document into the employee's personnel file.

HRD informed us that the monitoring of salary decisions includes a query and identification of all salary increases of 15% or more. The HRD Services and Support Division performs quality control procedures to ensure salary decisions are adequately documented and maintained on file in accordance with policies and procedures.

As noted above, we reviewed all six (6) of the salary increases of 15% or more effective after July 23, 2010 received by four (4) Executive Managers and two (2) Law Enforcement Managers. During our review, we found that:

- A. Supporting documentation for the salary increases of 15% or more granted to all four (4) Executive Managers complied with HRD's new policies and procedures.
- B. In two (2) instances, "base" salary increases of 15% or more, separate from premium pay, were granted to Law Enforcement Managers. The supporting documentation provided the reason for the salary action, new salary, and effective date. However, the supporting documentation did not show the prior salary, salary percentage increase, and the justification for the salary amount in accordance with HRD's new policies and procedures. As note earlier, HRD detected the two salary increases after they occurred and reminded the department of the new approval and documentation requirements. However, HRD's monitoring process to remind the department of the new requirements was not documented.



Although HRD took action to address our recommendation, documentation for certain salary actions by the granting department and monitoring actions by HRD was not complete, therefore; we consider this recommendation partially implemented.

Human Resources Department Planned Action:

The HRD Compliance Team will continue to monitor the salary increases of 15% or greater granted to Administrative Managers, Executive Managers, and Law Enforcement Managers for compliance with policy. If a department or agency is not in compliance with the policy HRD will contact them to resolve any issues and bring them into compliance.

We appreciate the cooperation and assistance extended to us by the personnel of the Human Resources Department during our First Follow-Up Audit. If you have any questions, please contact me directly or Eli Littner, Deputy Director at 834-5899, or Alan Marcum, Senior Audit Manager at 834-4119.

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors
Members, Audit Oversight Committee
Thomas G. Mauk, County Executive Officer
Bob Leys, Assistant Director, HR/Services and Support
Diane Greek, Manager, HR/Services and Support
Foreperson, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors